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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1955

No. 769

WAYNE HUGH EASLEY TRUST,
W. H. EASLEY, Trustee,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ROGER KENT EASLEY TRUST,
W. H. EASLEY, Trustee,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
to the United States Court of Appeals
for the Ninth Circuit.

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PETITION FOR A WRIT OF CERTIORARI
to the United States Court of Appeals
for the Ninth Circuit.

The above named petitioners by their counsel pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth

Circuit affirming the judgment of the Tax Court of the United States.

OPINION BELOW.

The opinion of the Tax Court is printed in 21 T.C. 51 and is set forth in the Transcript of Record at page 72 et seq. The opinion of the Court of Appeals is reported in ..... F. 2d ..... and is set forth in the appendix hereto.

JURISDICTIONAL STATEMENT.

The Tax Court had jurisdiction under Section 1101 of the Internal Revenue Code then in effect (Title 26, Section 1101 U.S.C.) to redetermine the deficiency assessed against petitioners.

Jurisdiction of the Court of Appeals to review the judgment of the Tax Court of the United States is conferred by Section 1141(a) I.R.C. (Title 26, Section 1141(a) U.S.C.) The judgment of the Court of Appeals was made and entered December 22, 1955.

Jurisdiction of this Court to review the judgment of the Court of Appeals is conferred by Title 28, Section 1254 United States Code.

QUESTIONS PRESENTED.

1. Settlors having irrevocably conveyed to each of two trusts for the benefit of their minor sons an undivided one-fourth interest in a going business and

the Tax Court having held the entire income from that business taxable to the settlors, are the trusts under a legal obligation to reimburse the settlors for any part of the tax deficiencies and interest thereon assessed to settlors by reason of the inclusion of trust income in the settlor's income?

2. Where income taxes paid by the trusts are refunded with interest because the trust income has been taxed to the settlors, are the trusts under a legal obligation to pay over the interest payments to the settlors?

3. Whether the interest payments received by the taxpayer-trusts in 1948 on their tax refund claims for the years 1940 through 1945 were includible in their gross incomes under Section 22(a) of the Internal Revenue Code.

4. Assuming the interest payments were includible in the taxpayer-trusts' gross incomes, whether as a result of their transfer to the settlors they were allowable deductions from the taxpayers' gross incomes either under Section 23(a) (1) (A) or (2) of the Code as ordinary and necessary business or nonbusiness expenses or under Section 23(b) as interest on indebtedness.

STATUTES AND REGULATIONS INVOLVED.

Internal Revenue Code:

Sec. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from

salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever . . . (26 U. S. C. 1946 ed., Sec. 22.)

Sec. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) (As amended by Sec. 121(a), Revenue Act of 1942, c. 619, 56 Stat. 798) Expenses.—

(1) *Trade or business expenses.*—

(A) *In General*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; . . .; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, or property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(2) *Non-trade or Non-business Expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or

maintenance of property held for the production of income.

(b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from the taxes imposed by this chapter. (26 U. S. C. 1946 ed., Sec. 23.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.22(a)-1. *What Included in Gross Income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. . . . In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. . . .

STATEMENT OF THE CASE.

The respondent determined deficiencies in the income taxes of each of the petitioners for the year 1948. The asserted deficiencies were based primarily upon a ruling that interest on a tax over-assessment received by each petitioner trust in 1948 is includible in the respective recipient's gross income for that

year. The petitioner applied to the Tax Court for a redetermination of the alleged deficiency pursuant to Section 1101 of the Internal Revenue Code then in effect. (Title 26, Section 1101 U. S. C.) The petitions were consolidated for hearing and all of the facts were stipulated to by the parties. The Tax Court found all of the facts in accordance with the stipulation and filed an opinion covering both cases. (21 T. C. 51.) Each of the petitioners filed a petition to review the Tax Court's decision with the United States Court of Appeals for the Ninth Circuit. A summary of the facts in these cases is set forth in the Tax Court's opinion, as follows:

> "The petitioners herein, the Wayne Hugh Easley Trust (hereinafter sometimes referred to as Trust No. 1) and the Roger Kent Easley Trust (hereinafter sometimes referred to as Trust No. 2) were created on October 1, 1940, by separate written Declarations of Trust of the same date executed by W. H. Easley and Margaret A. Easley as settlors. Since that date and throughout the period here involved, each petitioner has been a duly existing trust under the provisions of the respective Declarations of Trust and under and by virtue of the laws of the State of California. Since the creation of the trust and throughout the period involved, W. H. Easley has been the duly qualified and acting trustee of each petitioner-trust.
>
> "During the period here under review, each petitioner-trust kept its books of account and filed its income tax returns on the calendar year basis and on the cash method of accounting. Such returns were filed with the collector of internal

revenue for the first collection district of California.

"At all times material herein, the settlors of the trusts in question were husband and wife who, prior to October 1, 1940, conducted a business of bottling and selling a beverage known as 'Seven-Up' under a franchise from the Seven-Up Company of St. Louis, Missouri. Such business was conducted at San Francisco, California, and was known as the Seven-Up Bottling Company of San Francisco (hereinafter called the Bottling Company). Under the laws of the State of California, the business was the community property of the settlors.

"Under and by virtue of the Declarations of Trust of October 1, 1940, Easley and his wife, as settlors, transferred to W. H. Easley, as trustee of the trusts, respectively, an undivided one-fourth interest each in their business, the Bottling Company. They duly filed gift tax returns reporting as gifts the transfers thus effected and subsequently paid deficiencies in gift tax determined by respondent. For each of the years 1940 through 1945, a 'Partnership Return of Income' was filed in the name of the Bottling Company, in which returns the settlors and the petitioners were named as partners and one-quarter of the net income of the Bottling Company was reported as the respective share of each of these partners. Each petitioner-trust duly reported its share of the net income in its income tax returns.

"By decisions entered in Dockets Nos. 6287 and 6288 and promulgated January 27, 1947, reported as W. H. Easley, 8 T.C. 153, this Court determined that all of the income of the Bottling Com-

pany was taxable to the settlors of petitioner-trusts, Easley and his wife, as their community income. As a result thereof, deficiencies in tax and interest were assessed against the settlors and, correspondingly, overassessments of tax and credits for interest thereon were determined with respect to each of the petitioner-trusts for the taxable years 1940 through 1945. Pursuant to a 'consent to credit' executed and filed by W. H. Easley, Trustee, in behalf of each trust, and covering each of the aforementioned years, the collector of internal revenue applied the over-assessments of tax, so determined with respect to each petitioner-trust, in reduction of the deficiencies assessed against the settlors, or either of them, for such years and issued notices and demands for the remaining balance of the deficiencies, plus interest. The collector, during the year 1948, mailed to each petitioner-trust checks covering the interest allowed on the overassessments for the taxable years 1940 through 1945. Easley, as trustee for each trust, endorsed such interest checks and he and his wife, as settlors, or either of them, used the funds in part payment of the deficiencies in interest assessed against them or either of them, except as to the deficiencies of Margaret A. Easley for the years 1940 and 1941.

"The aggregate amount of the checks mailed to each petitioner-trust during 1948 covering interest allowed on the overassessments for the years designated was $27,842.05 and $27,517.65 for Trusts Nos. 1 and 2, respectively, as per the following schedule:

Year	Trust No. 1 Interest Allowed	Trust No. 2 Interest Allowed
1940	$ 279.81	$ 279.81
1941	5,373.83	5,063.12
1942	8,688.33	8,690.44
1943	5,669.42	5,654.85
1944	5,398.18	5,404.29
1945	2,432.48	2,425.14

"In computing its gross income for the taxable year 1948, each petitioner-trust excluded the total amount of interest checks received on the overassessments. In the determination of each petitioner's income tax liability for the year 1948, the respondent added the amount of such interest checks to each trust's net income disclosed by its return. The addition of such interest checks is the sole cause of the income tax deficiencies here in controversy.

"The settlors, Easley and his wife, on their 1948 income tax returns deducted, as interest paid on the deficiencies resulting from the taxation to them of the net income reported by petitioner-trusts, the interest deficiencies assessed against them reduced by the amount of interest checks received by petitioner-trusts. In determining overassessments against the settlors for the year 1948, respondent increased their respective deductions for interest by the amount of the interest checks received from petitioner-trusts." (R. 73-77.)

The "Consent to Credit" referred to in the Tax Court opinion is set forth and further explained in the opinion of the Court of Appeals in the following language:

Exhibit J is a letter of January 21, 1948, from the Commissioner of Internal Revenue to W. H. Easley, Trustee, as follows:

"Attention is invited to a tentative finding of the Bureau that income for the years 1940, 1941, 1942, 1943, originally taxed on your return, is apparently taxable to W. H. Easley and Margaret A. Easley, resulting in a proposed overassessment in your favor and a proposed deficiencies against W. H. Easley and Margaret A. Easley.

"If you will authorize the credit of your apparent overpayments to the proposed deficiencies in question, further consideration will be given, with a view to finally determining the tax liability of both parties and your consents to credit would relieve the apparent deficiency taxpayer of the payment of the additional tax to the extent of the amount of the proposed overassessment in your favor. Pending the receipt of such an agreement to credit, however, no overassessment is available for either credit or refund purposes.

"If this adjustment is effected, and a refund found to be due you after the application of the credit, a Treasury Check will be issued in settlement thereof, together with allowable interest.

"In the event this adjustment is satisfactory to you, it is requested that you sign the enclosed consents to credit and return them to this office, for the attention of IT:C1:CC3-DE.

"By direction of the Deputy Commissioner:

Respectfully,
P. H. Sherwood, Head of Division."

Exhibit F is as follows:

"Consent to Credit. W. H. Easley, Trustee.

I, Wayne Hugh Easley Trust of San Francisco, State of California, do hereby authorize the Commissioner of Internal Revenue to credit an overpayment of my income taxes in the amount of $772.96 and $16,706.04 for the years 1940 and 1941 to additional taxes in the amount of $43,-022.97 due from W. H. Easley of San Francisco, State of California, for the years 1940 and 1941. W. H. Easley, Trustee."

Like letters were written by the Commissioner and like consents given for the other years involved here.

The transfer was made, or credit given for the amount of the overassessments.

At the time the settlors created the two trusts for their small children in 1940, they believed that the trusts would be taxed as separate entities upon trust income and would pay the resulting income taxes from trust income. At the time, this belief was reasonable and was shared by hundreds and perhaps thousands of taxpayers who created similar trusts. *Helvering v. Clifford* had been decided, but on its facts it applied only to short term revocable trusts and did not seem to affect the taxability of the type of trust created by Mr. and Mrs. Easley. Soon the question of the taxability of family trusts and family partnerships became the most hotly contested issue in tax litigation and the Tax Court itself was so evenly divided upon the issue that the outcome of each individual case was apt to depend upon the personal

belief held by the member of the Court who happened to preside at the hearing.

The commissioner attempted by regulation, Reg. Sec. 39.22 (a)-21 to work out a set of rules from the conflicting court decisions and finally in 1954 the Congress placed the taxation of trust income on a definite and ascertainable basis by enacting Sections 671 through 678 of the Internal Revenue Code of 1954.

This Court clarified the taxation of income from family partnerships in *Com. v. Tower,* 327 U.S. 280, 90 L. Ed. 670, 66 S. Ct. 532, 164 A.L.R. 1135; *Lusthaus v. Com.,* 327 U.S. 293, 90 L. Ed. 679, 66 S. Ct. 539; *Com. v. Culbertson,* 337 U.S. 733, 93 L. Ed. 1661.

Mr. Easley attempted to solve his own problem by applying to the Superior Court of the State of California, in and for the City and County of San Francisco, for an order permitting him to purchase the interest of the respective trusts in the Seven-Up Bottling Company of San Francisco for $250,000.00 each. A guardian ad litem was appointed to represent the minors as beneficiaries of the trusts and after hearing the evidence, the Court made the orders which are included in the transcript of this matter. (R. 43-45.)

However, for the period 1940-1945, inclusive, Mr. and Mrs. Easley, like hundreds of other settlors in the same position, were confronted with the practical question of *who* was to pay the income taxes on the trust income. The Tax Court had held that the tax would be levied upon and collected from the settlors,

but did this mean that the trust would enjoy completely tax-free income? If this latter interpretation were correct, Mr. and Mrs. Easley might have to pay from 120% to 170% of their annual income in personal income taxes. Obviously, if they were compelled to do this for any prolonged period of time, it would not only bankrupt them, but put the Seven-Up Bottling Company of San Francisco out of business, thereby drying up the source of trust income as well. Common sense rebelled at such a thought.

Mr. and Mrs. Easley consistently took the position that while the trust income was taxed to them and at their surtax rate they were entitled to reimbursement from the trusts for all amounts of principal and interest expended by them on income tax deficiencies arising out of the inclusion of trust income to the settlors own income. The respondent apparently concurred in this view, because he insisted that the refund of taxes paid by the trusts be applied upon the settlors deficiencies. The crux of this case is whether or not, under the facts appearing in the record, the trustee is under a *legal obligation* either to *transmit* the interest in question to the settlors or to *reimburse* the settlors for the interest paid out by them to the Collector of Internal Revenue on account of interest on the deficiencies assessed against the settlors on income actually received by the trusts. If the duty existed, the interest was either excludable from gross income or deductible by petitioner trust. The Tax Court held that the trustee had neither a legal obligation to pay over the receipts in question to the set-

tlors or to reimburse the settlors for the money paid out by them. A majority of the Court of Appeals concurred in the finding of the Tax Court that there was no legal obligation imposed upon the trusts to reimburse the settlors.

"We do not agree with the contention of petitioners that the interest paid over to the settlors was a necessary expense. No legal obligation to reimburse the settlors was shown by the record here, and without such a showing, the interest would not be deductible by the taxpayer trust." The dissenting opinion in the Court of Appeals supports the contention of petitioners that the law will imply a legal obligation compelling the trust to make restitution in order to avoid unjust enrichment. As far as we have been able to learn, this is the first case to be decided upon the point and it is of vital interest to the numerous taxpayers who, like Mr. and Mrs. Easley, have assumed that the trusts are under an obligation implied by law to reimburse the settlors for expenditures made by the settlors by reason of the inclusion of trust income in the settlors own income.

REASONS FOR GRANTING THE WRIT.

THE WRIT SHOULD BE GRANTED BECAUSE THE COURT OF APPEALS HAS DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN, BUT SHOULD BE, DECIDED BY THIS COURT. The primary question is whether, upon the record, the

trusts have a legal duty to make restitution to the settlors to the extent that the trusts have been enriched for having their income tax burdens shifted from themselves to the settlors. This question has never been adjudicated and should be decided by this Court for the reasons hereinafter set out.

---

1. **THE CASE PRESENTS IMPORTANT QUESTIONS IN THE ADMINISTRATION OF THE TAX LAWS OF THE UNITED STATES.**

Petitioners argued in the Courts below that the interest received by petitioner trusts did not constitute gross income to petitioners because the trustee was under a *legal obligation* to restore the refunds of taxes and interest to the settlors. In the alternative petitioner argued that if said interests were held to be includable in the gross income of the trusts, then the trusts were under a *legal obligation* to reimburse the settlors for the interest they were compelled to pay upon their deficiencies in income taxes by reason of the inclusion of trust income in the settlors gross income. We argued that the amounts were deductible either as business expense or interest paid. The answer of the Courts below was that the legal obligation upon which we relied did not appear from the record. If such a legal obligation is imposed upon petitioners under the law of restitution the interest payments here involved did not constitute gross income to the trusts and if they are included in the trusts' gross income they should be held to constitute proper deductions from gross income.

2. WHETHER OR NOT SUCH A LEGAL OBLIGATION EXISTS IS OF VITAL IMPORTANCE TO VAST NUMBERS OF TAXPAYERS WHERE INCOME BELONGING TO A TRUST OR FAMILY PARTNERSHIP HAS BEEN HELD INCLUDABLE IN THE GROSS INCOME OF ANOTHER TAXPAYER.

We do not have statistics showing the number of taxpayers who may be affected by the principle here involved, but the reported decisions of the Tax Court, the United States District Courts, the Circuit Courts of Appeals and this Court, afford some indication of the number of taxpayers who have been held to be taxable on income legally belonging to someone else. It is a fair assumption that the proportion of taxpayers thus affected who have appealed to the Courts is relatively small. If the principle is allowed to stand that the trusts have no legal duty to reimburse the settlors under the circumstances of this case, the results could be disastrous, not only to Mr. and Mrs. Easley but to numerous other taxpayers. For example, there is no valid distinction between the right of the settlors to be reimbursed for the principal of the tax or the interest thereon. Therefore, the settlors might be legally compelled by the trusts (perhaps when the minor beneficiaries become of age) to repay the trusts for all of the tax refunds which the trustee applied to the settlors deficiency at respondent's suggestion. Naturally, Mr. and Mrs. Easley and most taxpayers similarly situated are in the higher income tax brackets. A decision that the trusts may enjoy their income free from income taxes while the settlors pay taxes in excess of their own gross income will work severe hardship on the settlors. The in-

come of the trusts was held to be includable in the gross income of the settlors in order to subject all of the income from the Seven-Up Bottling Company to taxation at the brackets at which it would have been taxed had the trust not been created. It was not the purpose of the Court to punish Mr. and Mrs. Easley for having created the trusts. The dissenting opinion in the Court of Appeals correctly analyzes the situation in these words: "The right so to do stems from the fact that it is apparent that it was never Easley's intent, or the intent of anyone, to distribute to the trusts sums free from tax. The amounts paid as tax by the trusts and later refunded, thus first came into the hands of the trusts solely as the unintended result of a mistake, and these refunded amounts were therefore owing, *ex aequo et bono,* to Easley because of the trust's unjust enrichment. See F. Restatement, Restitution, Sections 1, 49." The basic premise in the Tax Court opinion, and the majority opinion in the Court of Appeals, that the trusts have no legal obligation to reimburse the settlors, ignores the rules which have developed in modern times requiring restitution to prevent unjust enrichment at the expense of another.

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3. THE RULING OF THE COURTS BELOW CONSTITUTES AN UNJUST AND UNNECESSARY LIMITATION ON THE MODERN LAW OF RESTITUTION AND IF NOT CORRECTED WILL CONSTITUTE A HARMFUL PRECEDENT IN THE GROWTH AND EVOLUTION OF THAT PRINCIPLE.

We respectfully submit that the question of law here involved is an important one that this Court

should settle. The doctrine of Restitution is a modern doctrine and is vitally necessary to insure justice in our complex modern society. Restitution is described in 46 American Jurisprudence 99 as follows:

> "It is a general principle, underlying various legal doctrines and remedies, that one person should not be permitted to enrich himself at the expense of another, but should be required to make restitution of or for property or benefits, received, retained or appropriated, where it is just and reasonable that such restitution be made, and where such action involves no violation of frustration of law or opposition to public policy, either directly or indirectly."

The Courts below have simply refused to apply the well settled principles of restitution to a novel set of facts. Although the petitioners based their principle argument in their briefs submitted to the Court of Appeals and the Tax Court on a theory of restitution it is not adverted to in the opinion of the Tax Court or in the majority opinion in the Court of Appeals. Both Courts arbitrarily declared that the trusts had no legal duty to reimburse the settlors without discussion of the principle of restitution. The dissenting opinion correctly points out the principle and sets forth Sections 1 and 49 of the Restatement, Restitution, in the margin.

4. SINCE THIS COURT HAS LAID DOWN THE PRINCIPLES UNDER WHICH INCOME FROM CERTAIN TRUSTS AND FAMILY PARTNERSHIPS IS TAXED TO PERSONS OTHER THAN THOSE HAVING LEGAL OWNERSHIP OF IT, IT IS FITTING AND PROPER THAT THIS COURT SETTLE THE QUESTION OF WHETHER THE RECIPIENT OF SUCH INCOME IS OBLIGED TO MAKE RESTITUTION TO THE PERSON ACTUALLY PAYING THE TAX.

Mr. and Mrs. Easley were taxed on the trust income under a judicial interpretation of Section 22(a) of the Internal Revenue Code. As stated above, the doctrine was highly controversial and was not definite and ascertainable until Congress enacted the Internal Revenue Code of 1954. In our opinion the trust income would not have been includable in Mr. and Mrs. Easley's gross income had the 1954 Revenue Code been in effect during the years 1940-1945. Mr. and Mrs. Easley could not and did not anticipate, at the time they created the trust, that the trust income would be includable in their own gross income. In order to do justice, this Court should reverse the judgments in the Courts below based upon the false premise that there is no showing in the record of a legal obligation on the part of the trusts to reimburse the settlors. The record shows exactly why the trusts were held to have overpaid their income taxes and why those income taxes, and the interest thereon, were refunded by the Commissioner. The legal obligation is imposed by law. It is elementary that a duty imposed by law is not susceptible of proof by direct evidence as are a person's characteristics or a physical event. The existence of such a duty being a legal conclusion is shown by the application of

pertinent legal principles, whether a part of the law of tort, the law of restitution or the law of trust, to all of the facts of the case. Under the law of restitution the facts set forth in the record created in the petitioners an obligation to make restitution to the settlors. In holding to the contrary, the Courts below have incorrectly decided an important principle of Federal Law.

CONCLUSION.

The writ of certiorari should be issued.

Dated, San Francisco, California,
March 14, 1956.

CLYDE C. SHERWOOD,
Attorney for Petitioners.

(Appendix Follows.)

Appendix

United States Court of Appeals
for the Ninth Circuit

WAYNE HUGH EASLEY TRUST, W. H. EASLEY, Trustee, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 14,199
ROGER KENT EASLEY TRUST, W. H. EASLEY, Trustee, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	Dec. 22, 1955

Petition to Review a Decision of the Tax Court of the United States.

Before: DENMAN, Chief Judge, and POPE, Circuit Judge, and CLARK, District Judge.

CLARK, District Judge.

This matter is here on petition for review of the decision of the Tax Court. All of the facts were stipulated and as taken from the stipulation were summarized by the Tax Court as follows:

The petitioners herein, the Wayne Hugh Easley Trust (hereinafter sometimes referred to as Trust No. 1) and the Roger Kent Easley Trust (hereinafter

sometimes referred to as Trust No. 2) were created on October 1, 1940, by separate written Declarations of Trust of the same date executed by W. H. Easley and Margaret A. Easley as settlors. Since that date and throughout the period here involved, each petitioner has been a duly existing trust under the provisions of the respective Declarations of Trust and under and by virtue of the laws of the State of California. Since the creation of the trust and throughout the period involved, W. H. Easley has been the duly qualified and acting trustee of each petitioner-trust.

During the period here under review, each petitioner-trust kept its books of account and filed its income tax returns on the calendar year basis and on the cash method of accounting. Such returns were filed with the collector of internal revenue for the first collection district of California.

At all times material herein, the settlors of the trusts in question were husband and wife who, prior to October 1, 1940, conducted a business of bottling and selling a beverage known as "Seven-Up" under a franchise from the Seven-Up Company of St. Louis, Missouri. Such business was conducted at San Francisco, California, and was known as the Seven-Up Bottling Company of San Francisco (hereinafter called the Bottling Company). Under the laws of the State of California, the business was the community property of the settlors.

Under and by virtue of the Declarations of Trust of October 1, 1940, Easley and his wife, as settlors,

transferred to W. H. Easley, as trustee of the trusts, respectively, an undivided one-fourth interest each in their business, the Bottling Company. They duly filed gift tax returns reporting as gifts the transfers thus effected and subsequently paid deficiencies in gift tax determined by respondent. For each of the years 1940 through 1945, a "Partnership Return of Income" was filed in the name of the Bottling Company, in which returns the settlors and the petitioners were named as partners and one-quarter of the net income of the Bottling Company was reported as the respective share of each of these partners. Each petitioner-trust duly reported its share of the net income in its income tax returns.

By decisions entered in Dockets Nos. 6287 and 6288 and promulgated January 27, 1947, reported as W. H. Easley, 8 T.C. 153, this Court determined that all of the income of the Bottling Company was taxable to the settlors of petitioner-trusts, Easley and his wife, as their community income. As a result thereof, deficiencies in tax and interest were assessed against the settlors and, correspondingly, overassessments of tax and credits for interest thereon were determined with respect to each of the petitioner-trusts for the taxable years 1940 through 1945. Pursuant to a "consent to credit" executed and filed by W. H. Easley, Trustee, in behalf of each trust, and covering each of the aforementioned years, the collector of internal revenue applied the overassessments of tax, so determined with respect to each petitioner-trust, in reduction of the deficiencies assessed against the set-

tlors, or either of them, for such years and issued notices and demands for the remaining balance of the deficiencies, plus interest. The collector, during the year 1948, mailed to each petitioner-trust checks covering the interest allowed on the overassessments for the taxable years 1940 through 1945. Easley, as trustee for each trust, endorsed such interest checks and he and his wife, as settlors, or either of them, used the funds in part payment of the deficiencies in interest assessed against them or either of them, except as to the deficiencies of Margaret A. Easley for the years 1940 and 1941.

The aggregate amount of the checks mailed to each petitioner-trust during 1948 covering interest allowed on the overassessments for the years designated was $27,842.05 and $27,517.65 for Trusts Nos. 1 and 2, respectively, as per the following schedule:

Year	Trust No. 1 Interest Allowed	Trust No. 2 Interest Allowed
1940	$ 279.81	$ 279.81
1941	5,373.83	5,063.12
1942	8,688.33	8,690.44
1943	5,669.42	5,654.85
1944	5,398.18	5,404.29
1945	2,432.48	2,425.14

In computing its gross income for the taxable year 1948, each petitioner-trust excluded the total amounts of interest checks received on the overassessments. In the determination of each petitioner's income tax liability for the year 1948, the respondent added the amount of such interest checks to each trust's net income disclosed by its return. The addition of such

interest checks is the sole cause of the income tax deficiencies here in controversy.

The settlors, Easley and his wife, on their 1948 income tax returns, deducted, as interest paid on the deficiencies resulting from the taxation to them of the net income reported by petitioner-trusts, the interest deficiencies assessed against them reduced by the amount of the interest checks received by petitioner-trusts. In determining overassessments against the settlors for the year 1948, respondent increased their respective deductions for interest by the amount of the interest checks received from petitioner-trusts.

The questions presented are: Were the interest payments received by the taxpayer trusts in 1948 on their tax refund claims for the years 1940 through 1945 includible in their gross incomes under Section 22(a) of the Internal Revenue Code, and

Assuming the interest payments were includible in the taxpayer trusts' gross incomes, were they, as a result of their transfer to the settlors, allowable deductions from the taxpayers' gross incomes either under Section 23(a) (1) (A) or (2) of the Code as ordinary expenses or under Section 23 (b) as interest on indebtedness.

Section 22 (a) of the Internal Revenue Code is as follows:

> "Gross Income. Includes, gains, profits and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid or from professions, vocations, trades, businesses, commerce, or sales, or

> dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever . . ."

The statute is clear that interest is to be considered as gross income. No distinction is made as to interest of any source, whether it be earned because of overassessment of taxes or from investments made with the earning of interest specifically in mind. We see no merit in any contention made that interest on the overassessment was not includible.

The Petitioner-Trusts, during the years involved here, were entitled to any profits or benefits that accrued from their ownership, and as such recipients were obliged to show the interest payments received, as a part of their income.

Even though there was an overassessment for the years in question and this resulted in a refund of the amount of the overassessment and interest, this would not alter the fact that the interest was a profit accruing to the trusts and as such is taxable as income to the trusts. Schreiber v. Comm., 160 F. 2d 108.

The interest checks received by the taxpayers in 1948 were includible in their gross income under Sec. 22 (a). New Oakmont Corp. v. U.S., 86 F. Supp. 897.

Exhibit J is a letter of January 21, 1948, from the Commissioner of Internal Revenue to W. H. Easley, Trustee, as follows:

"Attention is invited to a tentative finding of the Bureau that income for the years 1940, 1941, 1942, 1943, originally taxed on your return, is apparently taxable to W. H. Easley and Margaret A. Easley, resulting in a proposed overassessment in your favor and a proposed deficiencies against W. H. Easley and Margaret A. Easley.

"If you will authorize the credit of your apparent overpayments to the proposed deficiencies in question, further consideration will be given, with a view to finally determining the tax liability of both parties and your consents to credit would relieve the apparent deficiency taxpayer of the payment of the additional tax to the extent of the amount of the proposed overassessment in your favor. Pending the receipt of such an agreement to credit, however, no overassessment is available for either credit or refund purposes.

"If this adjustment is effected, and a refund found to be due you after the application of the credit, a Treasury Check will be issued in settlement thereof, together with allowable interest.

"In the event this adjustment is satisfactory to you, it is requested that you sign the enclosed consents to credit and return them to this office, for the attention of IT:C1:CC3-DE.

"By direction of the Deputy Commissioner:

Respectfully,
P. H. Sherwood, Head of Division."

Exhibit F is as follows:

"Consent to Credit. W. H. Easley, Trustee.

I, Wayne Hugh Easley, Trust of San Francisco, State of California, do hereby authorize the

> Commissioner of Internal Revenue to credit an overpayment of my income taxes in the amount of $772.96 and $16,706.04 for the years 1940 and 1941 to additional taxes in the amount of $43,-022.97 due from W. H. Easley of San Francisco, State of California, for the years 1940 and 1941. W. H. Easley, Trustee."

Like letters were written by the Commissioner and like consents given for the other years involved here.

The transfer was made, or credit given for the amount of the overassessments.

The Petitioners make this further contention:

> "That the interest payments did not constitute gross income to them for the reason that they were under an obligation to pay over such interest to the settlors to whom in equity it rightfully belonged and that in the performance of such obligation they acted merely as conduits."

The Tax Court had before it the stipulation of facts hereinbefore referred to, and also the "Declaration of Trust" by which each of the trusts involved here was created. A study of the Declarations and the Stipulation of Facts presented to the Tax Court fails to reveal anything from which any inference might be drawn that there was any legal obligation to pass the payments to another. Indeed, quite the contrary appears. The declarations of trust involved here, contained the following:

> "Now, Therefore, in order to create such Trust and define the terms and conditions thereof, Wallace Herschel Easley and Margaret Alice Easley, hereinafter called the Settlors, do by these pres-

ents Grant, Transfer, Deliver and Set over unto the Trustee hereinafter designated all of the following described property, to-wit:

"An undivided one-fourth interest in and to that certain business conducted by the Settlors under the name of Seven-up Bottling Company of San Francisco, . . . That said business consists of the following assets and liabilities, to-wit: . . . To have and to hold all and singular the above granted premises and property and every part thereof unto the said Trustee, his successors and assigns, forever in fee simple; in trust, nevertheless unto and for the use, interest and purposes of this trust. . . ."

The Petitioners also contend that they were under a duty in equity, on the ground of unjust enrichment and under the doctrine of reformation and modification based upon mistake, to make restitution to their settlors of the tax refunds and interest on the refunds as a result of the holding in Easley v. Commissioner, 8 T.C. 153. There is nothing in the record to indicate other than that the taxes paid were paid out of trust money. Therefore, even though these taxes were paid on income which it developed later was taxable to Easley personally, the refund of the tax and the interest thereon were properly made to the trusts. Under the decision of the Tax Court, the Easleys personally, and not in Mr. Easley's capacity as trustee, were responsible for the tax on the income erroneously reported by the trusts. Thus, if the trusts were to pay the interest over to Mr. Easley it would be going to him personally rather than to him as

settlor of the trust. It is for this same reason that Mr. Easley does not have the right of exoneration or reimbursement from the trusts. When he paid the taxes called for by the Tax Court decision he paid them as an individual and not as trustee, and therefore the trusts are not responsible to him for the amount so paid.

We do not agree with the contention of petitioners that the interest paid over to the settlors was a necessary expense. No legal obligation to reimburse the settlors was shown by the record here, and without such a showing, the interest would not be deductible by the taxpayer trust.

The facts as set forth clearly show that the overpayments made by the trusts had already been included as income by the trusts and when returned did not constitute taxable income. As indicated by Exhibit J, the Commissioner suggested that these overpayments might be applied to the deficiency assessed against W. H. and Margaret Easley. However, in order that such application be made, it was necessary that Easley, as trustee, consent to credit amounts which, without such consents, would be refunded to the trusts. It was impossible for the Commissioner to suggest the same procedure on the interest which had accrued, because that amount had never been reported as income by any party. Further, by Exhibit J, the Commissioner stated that any amount found to be due the trust, after the application of the credit, would be refunded to the trust, together with the allowable interest. It was necessary that the interest

be returned to the taxpayer to whom it belonged, and that taxpayer must necessarily include it as taxable income for the year in which it was received.

The decision of the Tax Court must be, and is, AFFIRMED.

POPE, Circuit Judge, dissenting:

When the Commissioner wrote the letter, Exhibit J, enclosing the "Consent to Credit" set out in the court's opinion, he must have considered that he was proposing something which the addressee, the trustee, had a lawful right to do, namely to apply the sums refunded to the trust, upon his own obligation on the deficiency assessed against him as grantor. I cannot think the Commissioner was in this suggesting a breach of trust by Easley. He must have thought, as do I, that it was perfectly proper for Easley to make this application.[1]

And if it was appropriate thus to apply the principal of these refunds to Easley's personal tax liability, it was likewise proper for him to make a similar application of the checks for interest on these refunded amounts. This he did, as the opinion shows, by endorsing the checks and applying them, as far as they would go on his own interest obligation. It is impossible, logically or as a matter of law, to distinguish this right to apply the payments of principal, as the Commissioner suggested, from the right to apply the interest in like manner.

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[1]Parker v. Westover, 9 cir., 221 F. 2d 603, 606, describes an instance in which a California Superior Court, sitting in probate, appears to have approved a similar application of guardianship funds.

The right so to do stems from the fact that it is apparent that it was never Easley's intent, or the intent of anyone, to distribute to the trusts sums free from tax. The amounts paid as tax by the trusts, and later refunded, thus first came into the hands of the trusts solely as the unintended result of a mistake, and these refunded amounts were therefore owing, ex aequo et bono, to Easley, because of the trusts' unjust enrichment. Cf. Restatement, Restitution, §§1, 49.[2]

It follows that since the trusts were under obligation to reimburse Easley, sums upon which the interest was calculated were in substance Easley's property, and the interest belonged to him. In receiving the interest, and applying it to the credit of him to whom it belonged, the trusts were mere conduits, and the interest was not income to them. I would reverse the tax court decision.

(Endorsed:) Opinion and Dissenting Opinion. Filed Dec. 22, 1955. Paul P. O'Brien, Clerk.

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[2] "§1. Unjust Enrichment. A person who has been unjustly enriched at the expense of another is required to make restitution to the other."

"§49. (1) A person is entitled to restitution from another to whom gratuitously and induced thereto by a mistake of law he has given land or other things or has surrendered a claim if the mistake

(a) was caused by fraud or material misrepresentation, or

(b) was as to the identity or relationship of the donee or was some other basic mistake, or

(c) caused the donor to give other or more than he intended to give.

(2) In the absence of fraud, a donor who has made a basic mistake as to the amount of a gift is entitled to restitution of the surplus only."

California cases denying relief in cases of mistake of law are inapposite, for here the transaction is a gratuitous one.

United States Court of Appeals
for the Ninth Circuit

WAYNE HUGH EASLEY TRUST, W. H. EASLEY, Trustee, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 14,199
ROGER KENT EASLEY TRUST, W. H. EASLEY, Trustee, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	

JUDGMENT

Upon Petition to Review a Decision of The Tax Court of the United States.

This Cause came on to be heard on the Transcript of the Record from The Tax Court of the United States, and was duly submitted.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the Decision of the said Tax Court of the United States in this Cause be, and hereby is affirmed.

Filed and Entered: December 22, 1955.